

WASHINGTON STATE
DEPARTMENT OF
RETIREMENT
SYSTEMS

2002

SUMMARY

ANNUAL

FINANCIAL

REPORT

FOR THE YEAR ENDED JUNE 30, 2002

### Message From the Director

am pleased to present the Department of Retirement Systems (DRS) 2002 Summary Annual Financial Report. This report provides an overview of our services, funding and investment information, highlights of your retirement plans and a summary of the past year's achievements. We take pride in providing accurate, detailed accounting and the highest level of integrity regarding financial transactions.



John F. Charles

The past two years have been a period of upheaval in equity markets worldwide. In this past fiscal year alone, still reeling from the attacks of September 11, 2001 and corporate accounting scandals, investors suffered through two of the worst quarters in the U.S. equity market since 1926. Although the financial storm is rocking all boats, our state retirement funds continue to weather the storm better than most. As of June 30, 2002, the Washington State Investment Board (WSIB) managed retirement funds outperformed their public fund peers over the three-year and fiveyear time periods, as measured by the Trust Universe Comparison Service (TUCS) universe of public pension funds greater than \$1 billion in size.

At DRS, we focus resources and activities on providing effective services to you. With each new procedure implemented, our ability to provide you with accurate and timely information improves. An external study of public retirement administrations confirmed our pension administration is one of the most cost effective in the nation. (Please read the DRS Highlights section to learn more about this year's accomplishments.)

The vision of the staff at DRS is "Delighted Customers, Proud Staff." Our goal is to continue to introduce advanced technologies to produce results you expect and deserve. Our staff is proud of the service we provide, and look forward to serving you in 2003.

Please contact us with any comments or questions, or if you would like additional information. You can reach us at P.O. Box 48380, Olympia, Washington, 98504-8380, or by calling 1-800-547-6657. In the greater Olympia area please call 664-7000. Our Web site is available 24 hours a day and is located at www.wa.gov/DRS/. You may also request a copy of the Department of Retirement Systems' Comprehensive Annual Financial Report.

Sincerely,

John F. Charles

Director

DRS Vision: "Delighted Customers, Proud Staff"



### **DRS Highlights**

PERS Plan 3 implementation well under way The new Public Employees' Retirement System (PERS) Plan 3 officially went into effect on March 1, 2002. PERS Plan 3 combines the features of a defined benefit plan with those of a defined contribution plan. PERS members currently in Plan 2 must choose whether to transfer their contributions and service credit to Plan 3, or remain in Plan 2 with its defined benefit provisions. With almost 129,000 active PERS Plan 2 members, the opportunity to transfer is being offered in two phases. The transfer period for state workers and higher education employees is March 1 through August 31, 2002. Local government employees may transfer between September 1, 2002 and May 31, 2003. New PERS members will have 90 days from their first date of eligibility to decide which plan is right for them. DRS worked with employees, employers and labor organizations to design an extensive member education campaign. The PERS Plan 3 implementation is on schedule and within the project's established budget.

# New transmittal option saves employers' time, increases accuracy

The new Web-Based Employer Transmittal (WBET) option allows employers to quickly and securely report member information and retirement contribution data to DRS over the Internet. Already, 487 employers have signed up to use this option. With special features that increase accuracy, WBET's popularity with employers is easy to understand.

### Agency receives clean compliance audit

DRS takes its fiduciary responsibility very seriously. That diligence is evident in the results of a clean, 2001 audit completed by the State Auditor's Office. This was the agency's sixth consecutive annual audit without findings.

#### DRS returns funds to inactive members

The 2001 Legislature provided funding for DRS to conduct a special project to locate members with inactive accounts. The goal for the fiscal year ending June 30, 2002, was to contact 36,000 (45 percent) of the more than 80,000 members who are either not vested or are eligible to begin receiving retirement benefits. The agency exceeded the goal by contacting approximately 38,000 (48 percent) of those inactive members. As a result of this project, 4,579 withdrawals were made worth almost \$11.5 million, and 109 members began receiving their retirement benefits. Procedures were also developed to notify members with inactive accounts when they become eligible to retire or reach 70.5 years of age, meeting the legal requirement for mandatory distribution.

# Improved estimate letters are simple and comprehensive

DRS redesigned the benefit estimate letters to make them easier to read, while still providing all the details members need. The new format improves the appearance of the letters and clarifies important information. A focus group of retirement system members evaluated the new letters and found them to be straightforward and comprehensive.

# Independent study verifies DRS' operational efficiency

Results of an external study reveal that DRS operates very efficiently compared to other public retirement agencies. The *Benefit Administration Benchmarking Analysis*, conducted by Cost Effectiveness Measurement (CEM) Inc., of Toronto, Ontario, evaluates the administrative costs of public retirement systems. When comparing the 30 United States organizations that participated, this year's study shows that DRS' administrative costs were 44 percent lower than the projected costs of its peer pension systems, given complexity, volume, service levels, special projects and cost environment.

The study also identified DRS as the fourth most complex of the peer U.S. programs. This is DRS' third year participating in this study.

#### Agency fosters workforce diversity

DRS serves a diverse member base throughout Washington State and places a high value on maintaining a workforce that reflects that diversity. DRS strives to meet this goal through active recruiting strategies and programs aimed at retention of qualified staff.

## DRS continues its focus on improving customer service

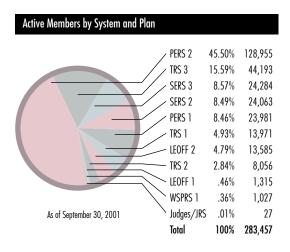
DRS staff respond to 96 percent of all routine correspondence within five days of receipt. In the Retirement Services Division, 96 percent of all incoming telephone calls are answered within 30 seconds. Recent implementation of a document imaging system provides rapid access to members' files, so many questions can be answered with a single telephone call. Responses to DRS' annual customer satisfaction survey show an average satisfaction rating of 4.55, out of a possible 5 points.

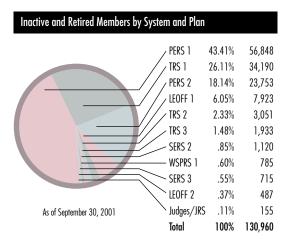
### Membership

Washington State's retirement systems provide high quality, secure retirement plans to employees across the state. The 12 statewide retirement plans managed by DRS serve almost 415,000 current, past and retired employees from state and local governments, kindergarten through grade 12 and higher education systems, fire, law enforcement and judicial agencies.

Active members, who currently work and pay contributions toward future retirement, comprise 68 percent of the public pension participation. The remaining members are either retired or have separated from public service.

The charts below illustrate the number of active and inactive/retired employees participating in Washington State's retirement systems.







DRS has enhanced its customer service center, making it even easier for you to get information about retirement and savings plans. To reach us, call 1-800-547-6657 or visit our Web site at www.wa.gov/DRS/.

You can also schedule an in-person consultation with one of our retirement specialists at our Tumwater headquarters, located at 6835 Capitol Boulevard. DRS is one of the most cost effective pension administrations in the nation.



### **Investment Summary**

The Washington State Investment Board manages retirement fund assets with the statutory requirement to maximize investment returns at a prudent level of risk. The retirement Commingled Trust Fund (CTF) decreased in value by \$3.93 billion during Fiscal Year 2002 to \$38.97 billion. The CTF investment return was negative 6.40 percent for the fiscal year.

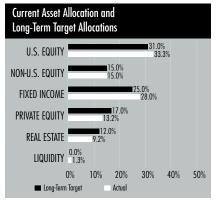
The table below shows the returns for the CTF on a total fund basis and by asset class.

| CTF Investment Returns<br>Performance as of June 30, 2002 |         |        |        |  |  |  |
|---|---------|--------|--------|--|--|--|
| Percentage  | 1 YEAR  | 3 YEAR | 5 YEAR |  |  |  |
| TOTAL FUND  | (6.40)  | .17    | 5.53   |  |  |  |
| U.S. EQUITY   | (16.88) | (7.66) | 3.91   |  |  |  |
| NON-U.S. EQUITY   | (7.41)  | (3.67) | (1.78) |  |  |  |
| FIXED INCOME  | 6.56    | 7.70   | 7.34   |  |  |  |
| LIQUIDITY   | 1.90    | 1.77   | 3.29   |  |  |  |
| REAL ESTATE   | 9.83    | 11.55  | 11.21  |  |  |  |
| PRIVATE EQUITY  | (12.90) | 4.36   | 8.87   |  |  |  |

Investment performance is a result of two primary factors: individual asset selection and the allocation of the portfolio among asset classes (e.g. stocks, fixed income, real estate).

Accordingly, the board sets a specific long-term target asset mix and adopts tight ranges around those targets to control the overall risk and return of the CTF. On a daily basis, the board reviews the asset allocation in relation to the established ranges. The staff shifts assets whenever the allocation range for an asset exceeds the approved range or when cash is needed elsewhere. The board reviews changes to the overall target asset mix every three to four years.

The chart below shows the CTF's asset allocation as of June 30, 2002, and long-term target allocations.



The table below shows the ten largest holdings in the CTF's U.S. equity market index fund as of June 30, 2002. The board invests in domestic stocks as part of an equity index portfolio and not as individual stock purchases.

| Largest US Equity Holdings as of June 30, 2002 |                                       |
|--|---------------------------------------|
| Name   | Percentage of<br>US Equity Index Fund |
| Microsoft Corp.                                | 2.54                                  |
| General Electric Co.                           | 2.48                                  |
| Exxon Mobil Corp.                              | 2.38                                  |
| Wal-Mart Stores Inc.                           | 2.10                                  |
| Pfizer Inc.                                    | 1.87                                  |
| Citigroup Inc.                                 | 1.71                                  |
| American Int'l Group                           | 1.53                                  |
| Johnson & Johnson                              | 1.35                                  |
| The Coca-Cola Co.                              | 1.19                                  |
| Int'l Business Machines                        | 1.06                                  |



It is never too early, or too late, to begin retirement planning.

#### **Financial Statement**

# Additions to Pension Plan Net Assets (Formerly called "Pension Trust Fund Revenues")

The primary sources of additions to the retirement trust funds include member and employer contributions and investment earnings. The main sources of additions to the deferred compensation plan include participant contributions and investment earnings. Total additions or revenues to the retirement trust funds and the deferred compensation plan for Fiscal Year 2002 amounted to a negative \$2,143.7 million. This decrease is \$349.3 million greater than the decrease experienced in Fiscal Year 2001.

The decrease in the additions to the pension trust fund occurred for two primary reasons: first, a decrease in retirement contributions from \$1,069.7 million in Fiscal Year 2001 to \$695.5 million in Fiscal Year 2002; second, a net investment income loss of \$2,988.9 million experienced in Fiscal Year 2002. Addition sources and their totals are listed in the chart to the right.

Pension and Other Employee Renefit Trust Funds by Plan

#### Deductions to Pension Plan Net Assets (Formerly called "Pension Trust Fund Expenses")

The retirement systems' primary trust fund deductions include the payment of benefits to retirees and beneficiaries, the refund of contributions to former members, and the cost of administering the retirement systems. Total deductions to the retirement trust funds and the deferred compensation plan for Fiscal Year 2002 totaled \$1,960.7 million. This is an increase of \$147.4 million from Fiscal Year 2001.

Benefit payments to members, including pension and annuity benefits, totaled \$1,755.6 million for Fiscal Year 2002. Refunds totaled \$175.1 million. Administrative expenses, which includes pension expenses incurred by DRS and the Offices of the State Actuary and Attorney General, totaled \$30 million. Expenses for the management of trust funds are incurred by the WSIB and funded from earnings on investments.

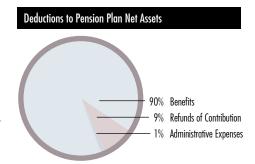
#### **Funding**

Valuations are performed for all DRSadministered retirement systems on a yearly (October 1 to September 30) basis.

The actuarial value of assets available as of the latest actuarial date, September 30, 2001, for all systems was \$45,053 million. The accrued liability was \$45,572 million. The accrued liability exceeds the net actuarial value of assets available for benefits by \$519 million.

The ratio of assets to liabilities is 99 percent compared to 101 percent last year. Current contribution rates remain in keeping with the goal of attaining a funding ratio of 100 percent, as required by Revised Code of Washington, chapter 41.45.

| Additions to Pension Pl                            | an Net Assets          | s (dollars in n        | (dollars in millions)            |                                      |  |
|--|------------------------|------------------------|----------------------------------|--------------------------------------|--|
|  | Fiscal<br>Year<br>2002 | Fiscal<br>Year<br>2001 | Increase<br>(Decrease)<br>Amount | Increase<br>(Decrease)<br>Percentage |  |
| Retirement Contributions                           | \$695.5                | \$1,069.7              | \$(374.2)                        | (35)%                                |  |
| Deferred Compensation<br>Participant Contributions | 119.0                  | 107.2                  | 11.8                             | 11%                                  |  |
| Net Investment Income                              | (2,988.9)              | (3,001.5)              | 12.6                             | _                                    |  |
| Charges for Services                               | 28.9                   | 28.9                   | -                                |                                      |  |
| Other Additions                                    | 1.8                    | 1.3                    | 0.5                              | 38%                                  |  |
| Total  | \$(2,143.7)            | \$(1,794.4)            | \$(349.3)                        | (19)%                                |  |



#### Statement of Plan Net Assets

| As of June 30, 2002 (expressed in thousands)               |                |                  |  |                  | PENSION TRUST                          |               |                 |                                       |                 |                 |           |         |         | AGENCY                         | TOTALS                   |                   |
|--|----------------|------------------|--|------------------|--|---------------|-----------------|---------------------------------------|-----------------|-----------------|-----------|---------|---------|--------------------------------|--------------------------|-------------------|
| ASSETS   | PERS<br>Plan 1 | PERS<br>Plan 2/3 | PERS Plan 3<br>Defined<br>Contribution | SERS<br>Plan 2/3 | SERS Plan 3<br>Defined<br>Contribution | TRS<br>Plan 1 | TRS<br>Plan 2/3 | TRS Plan 3<br>Defined<br>Contribution | LEOFF<br>Plan 1 | LEOFF<br>Plan 2 | WSPRS     | JRS     | JUDGES  | JRA<br>Defined<br>Contribution | Deferred<br>Compensation | Dependent<br>Care |
| Cash & Pooled Investments                                  | \$3,530        | \$3,125          | \$32                                   | \$5,151          | \$624                                  | \$6,695       | \$1,540         | \$2,223                               | \$2,993         | \$893           | \$640     | \$375   | \$4,783 | \$6                            | \$6,773                  | \$462             |
| Receivables  | 55,704         | 57,449           | 9,518                                  | 13,811           | 7,959                                  | 46,103        | 22,534          | 26,675                                | 23,789          | 16,546          | 3,249     | 40      | 13      | 0                              | 57                       | 0                 |
| Investments, Noncurrent                                    | 9,655,529      | 10,171,968       | 20,182                                 | 1,324,820        | 498,068                                | 8,245,693     | 3,308,666       | 1,680,158                             | 4,744,088       | 2,433,170       | 639,530   | 8,243   | 879     | 9,307                          | 1,352,998                | 0                 |
| Other  | 684            | 679              | 0                                      | 12               | 0                                      | 592           | 271             | 0                                     | 337             | 128             | 42        | 1       | 0       | 0                              | 0                        | 0                 |
| TOTAL ASSETS   | 9,715,447      | 10,233,221       | 29,732                                 | 1,343,794        | 506,651                                | 8,299,083     | 3,333,011       | 1,709,056                             | 4,771,207       | 2,450,737       | 643,461   | 8,659   | 5,675   | 9,313                          | 1,359,828                | 462               |
| TOTAL LIABILITIES  | 728,122        | 760,432          | 913                                    | 101,106          | 26,740                                 | 617,731       | 253,893         | 68,588                                | 351,593         | 179,033         | 47,553    | 224     | 891     | 1                              | 1,533                    | 462               |
| Net Assets Held in Trust for<br>Pension and Other Benefits | \$8,987,325    | \$9,472,789      | \$28,819                               | \$1,242,688      | \$479,911                              | \$7,681,352   | \$3,079,118     | \$1,640,468                           | \$4,419,614     | \$2,271,704     | \$595,908 | \$8,435 | \$4,784 | \$9,312                        | \$1,358,295              | 0                 |

This is a summary of the Comprehensive Annual Financial Report and is presented consistent with generally accepted accounting principles (GAAP). The pension trust funds are presented using the flow of economic resources measurement focus and the accrual basis of accounting. The agency fund does not have a measurement focus and is presented using the modified accrual basis of accounting. However, this presentation differs from GAAP in the following respects: financial data for the dependent care special revenue fund is not included, only selected financial data rather than financial statements are included, and this report only contains abbreviated note disclosures.

June 30, 2002 June 30, 2001 \$39,845 \$36,075 283,447 322,123 44,093,299 47,142,740 2.746 3,118 44,419,337 47,504,056 3,138,815 2,119,183 \$41,280,522 \$45,384,873

# Summary of Plan Provisions

A brief summary of retirement plans administered by DRS is provided below.
For more details, refer to the plan's member handbook, or the DRS Web site at www.wa.gov/DRS/.

| Plan   | Membership Eligibility   | Vesting   | Retirement Eligibility   | Benefit   |  |  |
|--|--|---|--|---|--|--|
| PERS Plan 1<br>(By 9/30/77)  | State employees, elected officials, employees of local governments, legislative committees, community/technical colleges, classified employees of school districts, district/municipal court judges, and some employees of the Supreme, Appeals, and Superior Courts | After five years of eligible service                              | Any age with 30 years of service, or at age 60 with 5 years of service or at age 55 with 25 years of service   | 2% of average final compensation (AFC) per year of service  |  |  |
| PERS Plan 2<br>(On or after 10/1/77)   | Same as PERS Plan 1, except classified school district employees; new employees hired on or after $3/1/02$ at state agencies and higher education, or on or after $9/1/02$ at all other employers, must choose Plan 2 or Plan 3                                      | After five years of eligible service                              | At age 65 with 5 years of service, or an actuarially reduced benefit at age 55 with 20 years of service  | 2% of AFC per year of service   |  |  |
| PERS Plan 3<br>(Varies by employer)  | Same as PERS Plan 2; new employees hired on or after 3/1/02 at state agencies and higher education, or on or after 9/1/02 at all other employers, must choose Plan 2 or Plan 3   | Varies  | At age 65 if vested or an actuarially reduced benefit at age 55 with 10 years of service (defined benefit portion)   | 1% of AFC per year of service (defined benefit portion)*  |  |  |
| SERS Plan 2<br>(On or after 9/1/00)  | All classified employees of school districts or educational service districts  | After five years of eligible service                              | At age 65 with 5 years of service, or an actuarially reduced benefit at age 55 with 20 years of service  | 2% of AFC per year of service   |  |  |
| SERS Plan 3<br>(On or after 9/1/00)  | All classified employees of school districts or educational service districts  | Varies  | At age 65 if vested or an actuarially reduced benefit at age 55 with 10 years of service (defined benefit portion)   | 1% of AFC per year of service (defined benefit portion)*  |  |  |
| TRS Plan 1<br>(By 9/30/77)   | All certificated public school employees   | After five years of eligible service                              | Any age with 30 years of service, or at age 60 with 5 years of service or at age 55 with 25 years of service   | 2% of AFC per year of service   |  |  |
| TRS Plan 2<br>(On or after 10/1/77<br>and by 6/30/96)  | All certificated public school employees   | After five years of eligible service                              | At age 65 with 5 years of service, or an actuarially reduced benefit at age 55 with 20 years of service  | 2% of AFC per year of service   |  |  |
| TRS Plan 3<br>(On or after 7/1/96)   | All certificated public school employees   | Varies  | At age 65 if vested or an actuarially reduced benefit at age 55 with 10 years of service (defined benefit portion)   | 1% of AFC per year of service (defined benefit portion)*  |  |  |
| LEOFF Plan 1<br>(By 9/30/77)   | All full-time, fully compensated law enforcement officers and fire fighters  | After five years of eligible service                              | At age 50 with 5 years of service  | 20+ years of service = 2% of final average salary (FAS) per year of service; $10-19=1.5\%$ FAS per year of service; $5-9=1\%$ FAS per year of service |  |  |
| LEOFF Plan 2<br>(On or after 10/1/77)  | All full-time, fully compensated law enforcement officers and fire fighters  | After five years of eligible service                              | At age 53 with 5 years of service or a benefit at age 50 with 20 years of service reduced 3% for each year under age 53  | 2% of FAS per year of service   |  |  |
| WSPRS Plan 1<br>(On or after 8/1/47 and<br>by 12/31/02)  | Commissioned employees of the Washington State Patrol  | After five years of eligible service                              | At age 55 or after 25 years of service   | 2% of average final salary per year of service  |  |  |
| JRS<br>(On or after 8/9/71 and<br>by 6/30/88 - New judges<br>on or after 7/1/88 join<br>PERS Plan 2) | Judges elected or appointed to the Supreme Court, the Court of Appeals and Superior Courts   | After 15 years of service   | At age 60  | 15+ years of service = $3.5\%$ of AFC per year of service; $10-15=3\%$ of AFC per year of service   |  |  |
| Judges<br>(By 8/8/71)  | Judges elected or appointed to the Supreme Court, the Court of Appeals and Superior Courts   | After 12 years of service   | At age 70 with 10+ years of service or any age with 18 years of service  | 1/2 of the monthly salary   |  |  |
| PERS, SERS and TRS Plan 3 ar<br>Employee contributions are de  | e defined benefit and defined contribution plans. Employers contribute to the defined bene<br>ermined by the individual employee. Gain sharing payments are applied on even numbere  | efit portion of the plan.<br>ed years, if the four-year return on | DRS publishes handbooks describing the rights and benefits for each system and plan, provided to members by their employers. They are also available from DRS and are or |   |  |  |
| investments exceeds 10 perce   |  | ,   | For more information, contact DRS at 1-800-547-6657. To receive this publication in an alternate format, call (360) 664-7097.  |   |  |  |

# Pension System Roles and Responsibilities

| Organization                              | Responsibility   | Membership and Contact Information   |
|---|--|--|
| Department of Retirement Systems (DRS)    | Collects and accounts for employer and employee contributions; maintains retirement records; pays benefits; communicates pension information; provides investment education; and administers the Deferred Compensation and Dependent Care Assistance Programs.   | The Governor appoints the director of DRS.  P.O. Box 48380, Olympia, WA 98504-8380 (360) 664-7000, in Olympia, or toll-free at 1-800-547-6657 www.wa.gov/DRS/  |
| Legislative Fiscal Committees             | Review and report on retirement bills to the full Legislature.   | The legislative fiscal committees are the House Appropriations Committee and the Senate Ways and Means Committee.  House Appropriations Committee P.O. Box 40600, Olympia, WA 98504-0600 (360) 786-7573 or toll-free 1-800-562-6000 (Legislative Hotline) www.leg.wa.gov  Senate Ways and Means Committee P.O. Box 40482, Olympia, WA 98504-0482 (360) 786-7715 or toll-free 1-800-562-6000 (Legislative Hotline) www.leg.wa.gov |
| Joint Committee on Pension Policy (JCPP)  | Studies pension issues and retirement finances. Develops pension policies and recommends pension legislation.  | The Joint Committee on Pension Policy is a bipartisan standing legislative committee composed of eight senators and eight representatives.  P.O. Box 40914, Olympia, WA 98504-0914 (360) 753-9144  |
| Pension Funding Council (PFC)             | Adopts economic assumptions for pension funding and member and employer pension contribution rates for PERS, SERS, TRS, LEOFF and WSPRS.   | Membership consists of the directors of DRS and Office of Financial<br>Management, and the Chairs and Ranking Minority Members of the Senate<br>Ways and Means Committee and House Appropriations Committee.<br>Can be contacted through DRS.  |
| Office of Financial Management (OFM)      | Advises the Governor on pension and funding policies and issues.   | The Governor appoints the director of OFM. P. O. Box 43113, Olympia, WA 98504-3113 (360) 902-0555 www.ofm.wa.gov   |
| Washington State Investment Board (WSIB)  | Invests and accounts for pension funds.  | Membership consists of the director of DRS; the state treasurer; the director of the Department of Labor and Industries; a state senator; a state representative; an active member of LEOFF, PERS, SERS, and TRS; and a retired member of one of the seven retirement systems.  P.O. Box 40916, Olympia, WA 98504-0916 (360) 664-8900 www.sib.wa.gov   |
| Office of the State Actuary (OSA)         | Acts as an advisory agency to the Legislature and director of DRS. Performs actuarial studies and reports on retirement bills. Creates formulas to compute benefit payment adjustments that are based on early retirement, cost-of-living or long-term survivor factors.   | The State Actuary is appointed by the Joint Committee on Pension Policy.  P.O. Box 40914, Olympia, WA 98504-0914 (360) 753-9144  |
| Employee Retirement Benefits Board (ERBB) | Provides recommendations to the WSIB on self-directed investment options for defined contribution plans; determines the payment options available for Plan 3 members; approves administrative charges assessed to members who participate in self-directed investment options; and provides recommendations on investment options for the Deferred Compensation Program. | Nine active and retired representatives of TRS, PERS and SERS, a Deferred Compensation Program participant and two investment professionals appointed by the Governor. The DRS director chairs the board. Can be contacted through DRS.  |
| DRS Advisory Committee                    | Serves in an advisory role to the director of DRS on retirement administrative issues.   | Twelve members representing active and retired members of the retirement systems administered by DRS. Can be contacted through DRS.  |